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QUESTION PRESENTED

Whether the taxpayer was taxable on the portion of the earnings of bus routes operated by it which under the terms of a purchase agreement it paid over to the company from which it purchased operating rights in the routes.

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 22. GROSS INCOME.
>
> (a) [as amended by Sec. 1 of the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *
>
> * * * * *
>
> (26 U. S. C. 1952 ed. 22.)

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STATEMENT

There is no dispute as to the facts, which were accepted by the Tax Court as stipulated (R. 6–9). The taxpayer, a Vermont corporation, operated bus routes in Vermont, New Hampshire, Massachusetts, Maine, and New York. A portion of its routes was also served by a similar carrier, Frontier Coach Lines, Inc. (hereinafter referred to as "Frontier"). (R. 7.)

Frontier, which had been operating at a loss, in 1939 offered to sell some of its operating rights to the taxpayer. While both parties desired to effectuate the transaction, they could not agree on price. (R. 7.) It was, therefore, agreed that Frontier would lease the rights to taxpayer until December 31, 1945, granting taxpayer an option to renew the lease for an additional five years, with an option to purchase at a price to be agreed upon by the parties. The lease provided that the taxpayer was to recover its expenses in operating the franchises on a stipulated mileage basis; that all revenues in excess of this amount were to be deposited monthly in an escrow account, unless there were unrecovered deficits in the expenses from previous months; that funds from the escrow were to be paid to Frontier on the basis of one cent a mile travelled in operation of the routes; that any revenues remaining were to be apportioned 75 percent to the taxpayer and 25 percent to Frontier; that the latter agreed to keep a connecting line in operation; and that the

lease was to go into effect when approved by the Interstate Commerce Commission. (R. 7–8.)

Taxpayer applied to the Commission for approval of the lease and option to buy. After a hearing, the examiner recommended disapproval of the agreement because Frontier's predicament would only be increased if at the termination of the lease taxpayer decided not to purchase the rights. (R. 8.)

A supplemental application was thereupon filed with the Commission requesting approval of a purchase agreement entered into on February 4, 1941, between taxpayer and Frontier. The agreement referred to the parties as "buyer" and "seller." The provisions of the purchase agreement were similar in many respects to the provisions of the lease. The seller was to "irrevocably transfer" the title to the operating rights 120 days after the Commission approved and authorized such transfer. The taxpayer, who was the buyer, was to pay $3,500 to the seller when title was transferred. The expenses of operation were to be computed in the same manner as in the lease agreement and the buyer was to recover expenses and $3,500 prior to making any deposits from operating revenues in the escrow account. The seller was then to get one cent a mile and the remainder was to be divided equally between the parties. This arrangement was to be operative for a period of five years. The seller re-

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served the right to inspect the books of the buyer. The seller again promised to maintain a connecting route with the buyer's routes and the buyer promised not to change or discontinue any of the acquired routes without the seller's approval. By an order dated May 4, 1941, the purchase was approved and authorized by the Commission; title to the rights was transferred on July 1, 1941; and an escrow agreement was entered into with a Burlington, Vermont, bank. (R. 8–9.)

The amounts paid from the escrow account to Frontier in 1942 and 1943 amounted to $54,262.18 and $37,347.78, respectively. The taxpayer claimed that it received no benefit from such amounts because they were collected for Frontier and, in this connection, the taxpayer alleged that Frontier had reserved an economic interest in the operating rights. The Commissioner determined deficiencies on the ground that the above sums were payments on the purchase price of the franchises, that such sums were gross income of the taxpayer when received, and that their character was not changed by subsequent payment to Frontier. (R. 6, 9.)

The Tax Court approved the Commissioner's determination and held that there were deficiencies in income tax for 1942 and 1943 in the amounts of $11.19 and $178.92, respectively. (R. 5, 13.) The Court of Appeals affirmed the decision of the Tax Court. (Pet. 24–29.)

ARGUMENT

1. The court below correctly held that payments made to the Frontier Coach Lines were part of the purchase price for the operating rights and that such sums had been previously earned by taxpayer in its business and were taxable to it under Section 22 of the Internal Revene Code of 1939, *supra*. In reaching this decision, the court pointed out that whether an agreement of purchase and sale conveys the entire interest in the property involved so as to make the purchaser taxable on all of the resultant earnings depends on the intent of the parties to be determined from the language of the agreement and from the circumstances surrounding it.

The facts here indicate an outright sale of a capital asset by Frontier without any reservation of an interest therein. The purchase agreement specified, *inter alia* (R. 44–45, 48):

> 1. The Buyer agrees to buy from the Seller and the Seller agrees to sell to the Buyer the operating rights of the Seller upon routes * * * more specifically described hereinabove * * *.
>
> 2. Seller will irrevocably transfer title to the operating rights to the Buyer on the Transfer Date * * *.
>
> 3. The Buyer, in consideration of the transfer of the operating rights, agrees to make payments to the Seller as follows:
>
> (a) The Buyer agrees to pay to the Seller on the Transfer Date Three Thou-

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sand Five Hundred Dollars ($3,500) in cash.

(b) The Buyer agrees to make payments to the Seller on the basis of the gross annual revenue from and mileage of operations by the Buyer during a period commencing on the Transfer Date and terminating five years thereafter * * *.

* * * * *

7. It is understood and agreed by and between the Seller and the Buyer that, from and after the Transfer Date, the operating rights of the Seller as described in paragraph 1 of this Agreement shall be unified with the operating rights of the Buyer, and that the Buyer shall have complete jurisdiction and control over operations under these rights and shall assume complete responsibility for same.

* * * * *

These provisions show that no control or interest was reserved by the seller, as is also indicated by the circumstances leading up to the agreement. As pointed out above, Frontier, which had been operating at a loss for some time, offered to sell its operating rights to the taxpayer in 1939 but they could not agree as to price. Accordingly, in the following year it was agreed that Frontier would lease its rights to taxpayer but the Interstate Commerce Commission refused to approve a lease. Consequently the parties executed an agreement for sale of the rights to taxpayer. This agreement was approved by the Interstate

Commerce Commission and in doing so it ordered taxpayer "before recording payment of any part of the purchase price upon its books, from time to time" to submit its related journal entries to the Commission. Thus, in contending here that the sole consideration for the purchase was the initial payment of $3,500, taxpayer disregards the Commission's interpretation of the agreement recognizing the later payments as being part of the purchase price. That was also the taxpayer's own interpretation of the agreement when it filed an application in 1943 (one of the taxable years here) with the Commission for permission to make certain changes in the purchase agreement. (R. 65–68.)

There is nothing in the facts to indicate that Frontier reserved any interest in the operating rights covered by the purchase agreement or that it received any portion of the payments as earned income. Thus, the Tax Court properly found (R. 11) that the payments involved here were actually income earned and received by taxpayer by operating its own buses with its own employees pursuant to the newly acquired operating rights and that such income was paid into escrow and eventually on to the seller to discharge the obligation which taxpayer assumed in order to acquire such rights.

2. There is no conflict in the decisions. Each case necessarily turns on the terms of the agreement therein and the pertinent surrounding cir-

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cumstances. Certainly there is a clear distinction between the instant case and those involving oil and gas agreements where ownership is by custom very frequently divided. *Burton-Sutton Oil Co.* v. *Commissioner,* 328 U. S. 25; *Kirby Petroleum Co.* v. *Commissioner,* 326 U. S. 599; *Thomas* v. *Perkins,* 301 U. S. 655; *Hamme* v. *Commissioner,* 209 F. 2d 29 (C. A. 4th), certiorari denied, 347 U. S. 954; and *Porter Royalty Pool* v. *Commissioner,* 165 F. 2d 933 (C. A. 6th), certiorari denied, 334 U. S. 833. As this Court pointed out in the *Burton-Sutton Oil Co.* case, Congress has recognized the peculiar character of the business of extracting natural resources and has provided for an equitable division of depletion allowances between assignors who reserve rights and assignees who are the operators. But even in cases involving oil property there has been no radical departure from the general principle that a person who buys property outright must pay taxes on the income subsequently produced therefrom even though it is agreed in advance that all of such income for a designated period will be used to pay the purchase price of the property covered by the agreement. See *Helvering* v. *Elbe Oil Land Co.,* 303 U. S. 372, holding that all of the oil rights there had been sold although part of the assignor's consideration was being paid from a percentage of the net profits.

Other cases relied on by taxpayer are also distinguishable. In *Central Life Assur. Soc., Mut.*

v. *Commissioner,* 51 F.·2d 939 (C. A. 8th), two types of life insurance business were involved but, while the company transferred both, it is clear that it actually sold only one of them and retained the beneficial interest in the other. Thus the income from the latter was properly held not taxable to the transferee. In *Mountain Producers Corp.* v. *Commissioner,* 92 F. 2d 78, 81 (C. A. 10th), it was held that the taxpayer who received the income involved, under a trust agreement was merely a conduit for the beneficial owner and was therefore not taxable on such income. Similarly, in *Shellabarger* v. *Commissioner,* 38 F. 2d 566 (C. A. 7th), where a testamentary beneficiary contracted with her sister to give her a share of the trust fund if she would not contest the will, the former was held not taxable on trust income she was obligated to pay to her sister. The same conclusion was reached in *Bettendorf* v. *Commissioner,* 49 F. 2d 173 (C. A. 8th), where a donor, who specifically reserved for life a right to the dividends from the stock which was the subject of the gift, was held taxable on such dividends.

But there was no reservation here of any interest in the operating rights and the taxpayer was not a conduit to pay over income earned by Frontier. Instead, taxpayer had purchased the entire interest in the rights and agreed to pay for them out of its earnings produced by its

own employees operating its own buses under the newly acquired rights.

CONCLUSION

This case presents no question of general importance. The decision of the court below is correct and there is no conflict. The petition for a writ of certiorari should be denied.

Respectfully submitted,

SIMON E. SOBELOFF,
Solictor General.
H. BRIAN HOLLAND,
Assistant Attorney General.
ELLIS N. SLACK,
LOUISE FOSTER,
Special Assistants to the Attorney General.

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